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The Chairman
Auditing and Assurance Standards Board
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Our ref PA_CH_Auditing
Standards_Exposure
Drafts_JB_051017.doc

17 October 2005

Dear Ms Kelsall

Exposure Drafts – ED 1/05, 2/05, 3/05, 4/05 and 5/05 (“the EDs”)

We are pleased to have the opportunity to comment on the above Exposure Drafts issued by the Auditing and Assurance Standards Board (AUASB). In developing our views and comments expressed in this letter, we have also considered the content of the Explanatory Guidance and Draft Preamble that have been issued by the AUASB.

We are fully supportive of the two phase approach being taken by the AUASB in order to satisfy the strategic objectives established by the FRC and the requirements for legal enforceability of the standards as required by CLERP 9.

As you will be aware, we have also been involved in the joint submission from the Auditing Standards Response Group (“ASRG”) on the EDs and support the recommendations contained in the letter from the ASRG to the AUASB dated 11 October 2005. We would however, like to take this opportunity to emphasise certain of the recommendations contained in the joint submission that we believe are of critical importance to achieving the desired outcomes and intentions of the AUASB in the redrafting process.

International conformity

We understand that as a result of its Clarity project, the International Auditing and Assurance Standards Board (“IAASB”) is expecting to release five Exposure Drafts of International Standards on Auditing as well as the proposed Clarity Explanatory Memorandum (equivalent to the Preamble) for public comment, following its next meeting on 19 October 2005.

We appreciate that these are only Exposure Drafts and that the application date of the resulting standards is likely to be for periods commencing on or after 15 December 2007, however, as the approval process for phase one of the Auditing Standards will last until February/March 2006, we believe it would be appropriate for the AUASB to consider the content of these documents, especially the Clarity Explanatory Memorandum in this process.

We also recommend that as part of phase 2 of the rewrite process, the AUASB consider aligning the format and structure of the Australian Auditing Standards with the Clarity format of the ISAs.

Ordinarily

We would like to reinforce the recommendation in the ASRG submission that the words “...and do not require documentation” are inserted into the interpretation of the word ordinarily in the Preamble. This provides additional clarity to the issue.

In addition, we believe that it is also fundamental that this area is addressed in the redraft of AUS 208 *Documentation* to ensure that no conflict exists between the documentation requirements of the Preamble and those that result from AUS 208.

Exposure process

Our comments on the EDs are based on the version of the Preamble dated 25 September 2005 that was placed on the AUASB website. We understand that this document will be amended and therefore, our comments in this letter may change as a result of amendments to the Preamble. We would therefore appreciate the opportunity to provide further comments on the EDs if necessary as a result of any such changes.

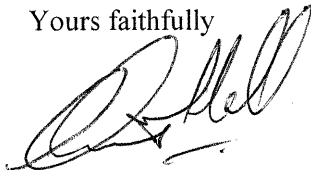
In addition, there are many references in the EDs to other standards, especially in relation to mandatory requirements. As further Exposure Drafts are issued, we would appreciate the opportunity to provide further comments on the EDs as they relate to cross-references between standards.

Minimal change

We support the phase one objective of minimal change to the Auditing Standards, however, we believe that certain changes are essential to avoid uncertainty in relation to the mandatory requirements and also any possible misinterpretation of their scope and extent. We have included details of these changes in the attached appendix, together with examples of situations that support the points raised above.

We would be pleased to discuss our comments with members of the AUASB or its staff. If you wish to do so, please contact me on 02 9335 7108.

Yours faithfully



Chris Hall
Partner

Exposure Draft – ED 1/05 “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement”

	Paragraph(s)	Issue noted	Recommendation
1	11 28 45 (all bold)	<p>No sense of scope is provided in these paragraphs that limits the extent or depth of understanding or identifies an objective for the basic principles they contain.</p> <p>For example, paragraph 45:</p> <p><i>The auditor shall obtain an understanding of the measurement and review of the entity’s financial performance</i></p>	<p>The Authority Statement as well as the Preamble should contain a clear statement as to the pervasive principles of:</p> <ul style="list-style-type: none"> - professional judgment - reasonable assurance; and - relevance to the audit of a financial report <p>In addition, the words relevant to the audit should be inserted into the mandatory requirement paragraph as is the case in paragraph 52.</p>
2	31 (grey)	<p><i>..Pursuant to paragraph 28 of this Auditing Standard, the auditor is required to consider whether local regulations specify certain financial reporting requirements for the industry in which the entity operates...</i></p> <p>This is an example of the explanatory guidance extending the mandatory requirements as the obligation to consider whether local regulations specify certain financial reporting requirements for the industry in which the entity operates is not included in the bold paragraph 28.</p>	<p>To avoid the possibility of explanatory guidance containing statements that require the auditor to perform, the qualifier “...is required to...” should be removed from the grey letter and either replaced by may/ordinarily or elevated to a mandatory requirement. Where any such elevations occur these should be made re-exposed for public comment through the normal exposure process.</p>

Paragraph(s)	Issue noted	Recommendation
<p>3</p> <p>32 (bold)</p>	<p><i>The auditor shall obtain an understanding of the nature of the entity.</i></p> <p>This is an example of where the mandatory requirements cannot be read in isolation from the explanatory guidance. The following explanatory guidance paragraph 33 states that:</p> <p><i>The nature of the entity refers to</i></p>	<p>This point reinforces the need to clearly define the purpose of definitions in the grey letter as stated in Recommendation 2 from the Auditing Standards Response Group.</p>
<p>4</p> <p>36 (bold)</p>	<p><i>The auditor shall obtain an understanding of the entity’s selection and application of accounting policies and consider whether they are appropriate for its business and consistent with the applicable financial reporting framework and accounting polices used in the relevant industry.</i></p> <p>This second half of this mandatory requirement should not apply to an audit of a special purpose financial report.</p>	<p>Revise paragraph to read</p> <p><i>The auditor shall obtain an understanding of the entity’s selection and application of accounting policies. For audits of general purpose financial reports the auditor shall consider whether they are appropriate for its business and consistent with the applicable financial reporting framework and accounting polices used in the relevant industry.</i></p>



Exposure Draft – ED 2/05 “The Auditor’s Procedures in Response to Assessed Risks”

	Paragraph	Issue	Recommendation
1	7 (grey)	<p>The paragraph refers to AUS 210 <i>The Auditor’s responsibility to consider Fraud and Error in an audit of a financial report.</i></p> <p>The name of this standard is incorrect.</p>	<p>Revise name of the standard to</p> <p><i>The Auditor’s responsibility to consider Fraud in an audit of a financial report.</i></p>
2	30 (grey)	<p>This grey letter paragraph refers to two bold paragraphs (31 and 34) and uses the words as required by...but uses different words that they be misleading or confusing.</p>	<p>Suggested rewording for paragraph 30</p> <p>Pursuant to paragraphs 31 and 34 of this Auditing Standard, the auditor is required to perform test of the operating effectiveness of controls when the auditor’s risk assessment includes an expectation of the operating effectiveness of controls or when it is not possible or practicable to reduce the risks of material misstatement at the assertion level to an acceptably low level with audit evidence obtained from substantive procedures only.</p>



Exposure Draft – ED 3/05 “Audit Evidence”

	Paragraph	Issue	Recommendation
1		No comments	



Exposure Draft – ED 4/05 'External Confirmations' (re-issuance of AUS 504)

Paragraph	Issue	Recommendation
1 8 (Grey)	<i>External confirmations are frequently used in relation to account balances.....</i>	Replace the words <i>...frequently used...</i> with <i>...may be used...</i>
2 34 (bold)	<i>When performing confirmation procedures, the auditor shall maintain control over the process of selecting...</i> <i>Paragraph 35 as an explanatory paragraph states that:</i> <i>...the auditor is required to ensure that it is the auditor that who sends out the confirmation requests, that the requests are properly addressed...</i> In addition to extending the mandatory requirement in paragraph 34, it is unrealistic to require the auditor to ensure that the requests are properly addressed.	The words in paragraph 35 <i>...is required to ensure...</i> Should be removed and replaced with the words <i>...ordinarily ensures ..</i>



Exposure Draft – ED 5/05 “Existence and Valuation of Inventory” (re-issuance of AUS 506)

	Paragraph	Issue	Recommendation
1	Main changes para 4	This point is confusing and unclear what has actually changed.	Revise wording to be clearer as to what has actually changed in the standard.
2	11 (bold)	<p><i>When inventory is material to the financial report, the auditor shall obtain sufficient appropriate audit evidence regarding its existence and condition by attendance at physical inventory counting unless impractical</i></p> <p>This paragraph suggests that sufficient appropriate evidence about existence and condition should be obtained solely from attendance at the inventory count. This is unrealistic, especially in relation to condition.</p>	<p>Reword as follows:</p> <p><i>When inventory is material to the financial report, in obtaining sufficient appropriate audit evidence over existence and condition of inventory, the auditor shall attend physical inventory counting unless impractical</i></p> <p>Greater guidance and examples should also be provided to clarify what is meant by impracticable.</p>
3	27 (bold)	<p><i>The auditor shall perform audit procedures over the final inventory listing....</i></p>	<p>It may not always be practical to obtain a final inventory listing we recommend that this be changed to final inventory quantities.</p> <p>It is unclear as to what is meant by shall perform audit procedures. Guidance should be provided as to what these may include.</p>